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SUBJECT: KOSOVO: NOTHING NEW IN SERBIA'S ENERGY PROPOSAL; SOME
POSITIVE ELEMENTS IN THE EU'S

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SENSITIVE BUT UNCLASSIFIED Q PLEASE PROTECT ACCORDINGLY

11. (SBU) SUMMARY: The Serbian Ministry for Kosovo, on January 29, submitted a proposal to the Kosovo Energy Company (KEK) to resolve the current standoff over assets and the provision of electricity in northern Kosovo. The proposal offers to establish the Serbian Electricity Company (EPS) as a second energy provider in Kosovo and transfers several Kosovo electricity assets to EPS. It uses ethnicity, rather than commercial considerations, to drive energy provision in Kosovo, and it would partition electricity service along ethnic lines. Finally, Serbia's proposal threatens to undermine the GOK's ongoing efforts to privatize electricity production and distribution and would diminish the value of Kosovo's electricity assets ahead of privatization. Not surprisingly, KEK plans to reject it. That said, we have reviewed an EU proposal, elements of which could contribute to resolving the electricity situation in the north. Based on our preliminary assessment, much of it is consistent with proposals KEK has already made to its Serbian interlocutors, and it is worth exploring further. The EU proposal's chief flaw is that it would force KEK to surrender its hard-won commercial position south of the Ibar River, something that we do not believe would be wise for the international community to force on the GOK and KEK. END SUMMARY

A SERBIAN "SOLUTION" TO ELECTRICITY IN KOSOVO

12. (SBU) On January 29, Serbian Assistant Minister for Kosovo Dragan Petkovic sent to the Kosovo Energy Company (KEK) a written proposal for resolving the standoff over electricity in northern Kosovo. The proposal would position the Serbian Electricity Company (EPS) as a second full-service electricity provider throughout Kosovo, something rejected by UNMIK and KEK in 2007, and as we have reported previously, something that has never been on the table in the nine-month negotiation between EPS and KEK over regularizing KEK's

non-paying Serb electricity customers. The focus of these talks has always been on the establishment of a Kosovo-registered company, or ESCO, that would provide energy services on KEK's behalf to Kosovo Serb consumers (e.g., meter reading, billing, and bill collection). EPS refused to engage on the ESCO proposal. As a consequence, KEK proceeded on its own to regularize Kosovo Serb customers in the south, including at Serbian Orthodox monasteries, without the ESCO. This arrangement is working well.

MAY I HAVE A HYDRO PLANT WITH MY SUB-STATION, PLEASE

13. (SBU) The Serbian proposal calls for KEK to give up the hard-won commercial gains that it made in the south, gains that were critical catalysts to the political progress we made among Kosovo Serbs south of the Ibar River over the last six months of 2009. (Note: We suspect that concerns about the latter are the driving factor behind Belgrade's desire to re-open the ESCO issue in the south. End Note) However, Serbia's proposal goes well beyond reversing KEK's progress in the south with regularization of non-paying customers. In effect, it seeks an ex post facto sanction for its illegal seizure of KEK's electricity assets in the north (i.e., Valac and other substations as well as transmission and distribution lines). The proposal also broadens EPS/EMS claims to Kosovo assets to include the Ujmani/Gazivoda hydroplant in the north. Even more boldly, it calls for the right to develop small hydro concessions in Shterpce/Strpce municipality in Kosovo's south.

ETHNICITY, ELECTRICITY, AND POWER PROVISION

14. (SBU) The fundamental essence of the Serbian proposal is that all aspects the electricity sector -- generation, transmission,

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distribution, and supply -- should be organized along ethnic lines. Kosovo Serbs would get power from Serbs; Kosovo Albanians from Albanians. There is a distinction between this notion and the proposal made by KEK that a Serbian-based, but Kosovo-registered company, could provide electricity services to Kosovo Serbian enclaves. Belgrade's proposal has obvious political shortcomings given our long-term objectives in Kosovo. We cannot integrate Kosovo's Serbs into Kosovo society or ensure long-term stability here if Serbia is allowed to create hostile, parallel societies and structures within Kosovo. That said, the Serbian proposal also violates common sense commercial principles for today's Kosovo. Although it may be true that in a liberalized market of the future there might be room for multiple service providers, and that consumers would be willing to pay more for "ethnically pure power", the costs of such a system with today's electrical infrastructure would be prohibitively high.

FLUSHING YEARS AND MILLIONS OF DOLLARS DOWN THE DRAIN

15. (SBU) There are other problems with Serbia's proposed approach. Establishing an ethnically-divided power generation, transmission, distribution, and supply system (whether north and south of the Ibar, or just north of the Ibar) would undermine U.S.-led efforts to privatize KEK electricity production and distribution assets. This multi-year effort, in which we and others in the international community have invested tens of millions of dollars, is critical to Kosovo's long-term economic viability. Without a rational energy sector, economic development and growth will not take place. We are now close to success on the New Kosovo Power Plant and privatization of the electricity distribution company. Serbia's proposal would put these efforts at serious risk. It calls into question the ownership of the assets themselves; it would fundamentally undermine the profitability of the private businesses.

AN EU PROPOSAL OFFERS OPPORTUNITIES FOR PROGRESS

16. (SBU) We understand that Robert Cooper, Director General External and Politico-Military Affairs at the General Secretariat of the Council of the European Union, on February 2 passed to EUR Assistant

Secretary Gordon an EU proposal for breaking the current impasse. We have looked closely at it (though we have not shared it with anyone), and we believe that it contains elements that could contribute to a constructive resolution of the situation. The EU proposal helpfully makes clear that KEK is to be the "exclusive supplier and provider of electricity in Kosovo." In essence, the proposal appears to call for the creation of an ESCO, though the EU has cast this entity as SECK Q Serbian Electricity Company in Kosovo." It would allow for SECK to act as a billing agent for KEK and to provide maintenance at and manage certain facilities "in defined areas." KEK has already made similar offers to Belgrade. The major flaw with the EU proposal is that it requires KEK to give up its hard-won gains in the south, which the GOK and KEK are not likely to accept, absent a reciprocal move by Belgrade to permit KEK equal access to the Serbian energy market.

COMMENT

17. (SBU) Public pressure is growing on the GOK and KEK to reassert their control over the north. We should not expect the GOK to acquiesce indefinitely and allow Serbia to entrench its position on electricity in the north, and from our perspective, reestablishing KEK's control over its assets is a critical step in the longer term effort to unseat Belgrade's illegal parallel structures there. Unsurprisingly, KEK has already indicated to us that Serbia's proposal as it stands right now is unacceptable, and KEK plans to formally convey this to Serbia by February 5. Fortunately, the EU seems to agree for once. On the other hand, the EU proposal offers a possible way forward. Much of it is consistent with proposals KEK has already made to its Serbian interlocutors, and it is worth exploring further. It would be a mistake, however, for the

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international community to force KEK (or the GOK) to accept an EU proposal to re-open discussions on an ESCO-type arrangement for the south. Belgrade lost that argument last year as a result of its stonewalling, and rolling it back would be disastrous for the newly empowered, legitimate Serb-led municipalities. The EU has offered no good justification for trying to impose this on Pristina other than a disingenuous reference to the Athens Treaty and the *acquis communautaire*. Were this a genuine basis for such a proposal it would have to be based on reciprocal arrangements wherein both parties had equal rights as service providers on the other's territory.

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